

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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Bell Operating Company Provision
of Out-of-Region Interstate,
Interexchange Services

CC Docket No. 96-21

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REPLY COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION

MCI TELECOMMUNICATIONS CORPORATION

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Dated: March 25, 1996

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SUMMARY

The weight of the well-reasoned initial comments supports MCI's position that the Commission's proposal for BOC out-of-region interexchange services is too lax and that such services should be subject to additional safeguards.

Some of the comments raise various procedural issues. BellSouth and other BOCs argue that the Telecommunications Act of 1996 (1996 Act) precludes any separate affiliate condition or other regulatory restraints on BOC out-of-region interexchange services, since the 1996 Act authorizes unconditional BOC entry into such services. That statute clearly states, however, that it does not modify the Commission's existing authority as to any matters not expressly addressed. Since the 1996 Act is silent as to the manner in which BOC out-of-region interexchange service should be regulated, the Commission retains full authority to impose separate subsidiary requirements and dominant carrier regulation on such services.

BellSouth raises another issue as to the scope of this proceeding, namely, whether it covers out-of-region interexchange service provided in conjunction with a BOC's own CMRS, which BellSouth asserts is "incidental" interexchange service under the 1996 Act. Whether or not such service is incidental under the Act, it is also out-of-region interexchange service and should be addressed in this proceeding, especially in light of the opportunities for abuse arising from the BOC's control of the "wireless bottleneck."

The initial comments also confirm the BOCs' continuing local bottleneck control and ability to project that power into out-of-region interexchange services. The BOCs point to various factors that supposedly prevent the exercise of their admitted local exchange and access dominance in out-of-region interexchange services, such as the geographical separation of their local and out-of-region services, price cap regulation, local competition, the size of their IXC competitors and the alleged ease of detection of access discrimination. In fact, however, such geographical separation and price cap regulation are irrelevant to the conferring of monopoly-derived benefits of a company-wide nature on the BOC's interexchange services; local competition is still in its infancy; and the BOCs have available to them a wide variety of discriminatory actions that raise competitors' costs and that are hard to detect or remedy, especially where access is provided by a BOC joint venture.

Accordingly, BOC out-of-region interexchange services should be subject to mandatory separate subsidiary requirements, dominant carrier regulation and other accounting safeguards. Moreover, the proposed separation conditions should be strengthened so as to ensure complete physical, administrative and operational separation, along the lines of the separate subsidiary requirements in the 1996 Act. Since the BOCs will be establishing separate subsidiaries as required by the 1996 Act for their in-region interexchange services, it will not pose an undue burden to use the same entities for out-of-region services.

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REPLY COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION

MCI Telecommunications Corporation (MCI), by its undersigned attorneys, hereby replies to the initial comments concerning the Commission's proposal to regulate "out-of-region" interstate, interexchange services of the Bell Operating Companies (BOCs) as "dominant" services unless they are offered through a separate affiliate meeting the Commission's Competitive Carrier criteria.^{1/} The weight of the well-reasoned comments supports MCI's view that the Commission's proposal is too lax, especially as an interim measure, and that, whether or not the Commission decides to grant BOC out-of-region interexchange affiliates nondominant status, such affiliates must be subjected to additional safeguards.

I. PROCEDURAL ISSUES

The initial comments raise a number of procedural issues. First, some of the BOCs, especially BellSouth, claim that the Telecommunications Act of 1996 (1996 Act) precludes any separate affiliate requirement or, indeed, any Commission-imposed

^{1/} Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Therefor, CC Docket No. 79-252. The full history of this proceeding is set forth in footnote 2 in MCI's initial Comments.

restraints on BOC out-of-region interexchange services. They argue that the imposition of dominant carrier regulation or separate affiliate requirements on such services contravenes the "deregulatory" intent of the 1996 Act.^{2/}

Along the same lines, they point out that the 1996 Act authorizes the provision of BOC out-of-region interexchange services immediately after the date of enactment, with no waiting period or preconditions, and that the contrast between such unconditional entry and the separate subsidiary and other conditions placed on BOC entry into in-region interexchange services reflects Congress's intent that out-of-region services remain completely free of any restraints. Some of the BOCs cite Senator Pressler's February 21, 1996 letter criticizing the Notice in this proceeding and the Commission's approach to implementation of the 1996 Act in support of their arguments.^{3/}

SBC Communications inadvertently rebuts these points, however, in correctly noting that "[d]ominant' and 'non-dominant' interexchange carrier regulation is not addressed in the Telecommunications Act."^{4/} The Act is silent on that topic, as well as many others within the ambit of this Commission's remaining authority under the Communications Act of 1934. As to all of the subjects not mentioned in the 1996 Act, that law is clear: "[t]his Act and the amendments made by this Act shall not

^{2/} See, e.g., BellSouth Comments at 3-4.

^{3/} See, e.g., Bell Atlantic Comments at 4-5.

^{4/} Comments of SBC Communications Inc. at 4.

be construed to modify, impair or supersede Federal ... law unless expressly so provided in such Act or amendments."^{5/}

Moreover, the separate subsidiary provision in the 1996 Act, cited by the BOCs as evidence of Congress's intent that BOC out-of-region interexchange services remain free of any restraints, states that "[n]othing in this subsection shall be construed to limit the authority of the Commission under any other section of this Act to prescribe safeguards consistent with the public interest, convenience and necessity."^{6/} There is no express limitation on the range of such additional "safeguards," which therefore may include additional separate subsidiary requirements.

The silence in the 1996 Act as to dominance and nondominance and its explicit invitation to the Commission to impose additional safeguards thus admit of only one conclusion -- Congress intended to leave all such regulatory issues entirely up to the Commission. As the heading in Section 601(c)(1) states, the 1996 Act has "no implied effect" on Commission policies.

As for Senator Pressler's letter, that represents the opinion of only one legislator, which has no legal effect and certainly no more significance than Senator Hollings' recent response to Senator Pressler's letter. Senator Hollings stated that "the legislation does not prohibit the FCC from requiring an

^{5/} Section 601(c)(1) of the 1996 Act.

^{6/} Section 272(f)(3) of the Communications Act, added by Section 151 of the 1996 Act.

RBOC from using [sic] a separate subsidiary for out-of-region interLATA services.... The legislation leaves this question to the FCC."^{7/} That statement is clearly more consistent than Senator Pressler's letter with the language of the 1996 Act.

The second procedural matter raised by some of the parties relates to the scope of this proceeding, especially the identification of what exactly constitutes BOC out-of-region interexchange services under the 1996 Act.^{8/} BellSouth raises a distinction between BOC out-of-region interexchange service provided to customers of other commercial mobile radio service (CMRS) providers, which it believes to be encompassed by this proceeding, and BOC out-of-region interexchange service provided in conjunction with the BOC's own CMRS, which it believes should be treated separately, since Congress exempted all interexchange CMRS as an "incidental service" from the separate subsidiary requirement in the 1996 Act.^{9/}

^{7/} Letter from the Hon. Ernest F. Hollings to the Hon. Reed E. Hundt, Chairman, FCC, dated February 29, 1996.

^{8/} Pacific Telesis asserts that the holding in the Fifth Report in Competitive Carrier that separate local exchange carrier (LEC) interexchange affiliates will be regulated as nondominant carriers, 98 FCC 2d at 1195-1200, applies to BOCs and that there is, therefore, no need for this proceeding. Pacific Telesis does not satisfactorily explain, however, why the more specific statement about separate BOC interexchange affiliates in the same order -- that they should be regulated as dominant until the Commission can make a further determination, 98 FCC 2d at 1198 n.23 -- may be ignored. Since each BOC controls such a large contiguous local service area, relative to the LECs, it is certainly rational to treat BOCs more stringently. See Sprint Comments at 4.

^{9/} See BellSouth Comments at 18-20.

As discussed above, however, the scope of the separate subsidiary requirement in the 1996 Act is irrelevant here. Whether or not BOC provision of interexchange CMRS is covered by the statutory separate subsidiary requirement has no effect on whether the Commission should impose a separation requirement of its own or other regulations on such services. It may be that some services may fall into both the incidental and out-of-region categories defined in the 1996 Act.^{10/} BellSouth has not advanced any sound policy reason, however, for excluding some out-of-region interexchange services from the scope of this proceeding simply because the originating access for the calls is provided by its own CMRS, rather than another entity's CMRS or the local wireline carrier.

Indeed, because of the "wireless bottleneck,"^{11/} the dangers of cross-subsidization and discrimination may well be greater when an out-of-region interexchange call originates from the BOC's own CMRS. Moreover, where a BOC provides the interexchange link between its own originating out-of-region CMRS customer and its terminating in-region CMRS customer, the BOC is involved in all three stages of the interexchange call, multiplying its

^{10/} Compare Section 271(b)(2) and (j) with Section 271(b)(3) and (g), added by Section 151 of the 1996 Act. MCI agrees with the Competitive Telecommunications Association's (CompTel's) suggestion that "incidental" out-of-region interexchange services should be treated the same as all other out-of-region services. See CompTel Comments at 14.

^{11/} See United States v. Western Electric Co., 890 F. Supp. 1, 3 (D.D.C. 1995).

opportunities for discrimination and cost shifting.^{12/}

On another procedural point, AT&T correctly points out that this proceeding would not seem to cover BOC out-of-region international services, since the dominance or nondominance of such services requires a country-by-country analysis beyond the scope of this proceeding.^{13/} In fact, some of the same factors that require a country-by-country analysis might also indicate that out-of-region, international, facilities-based, switched service should be subject to certain restrictions unless and until the BOC obtains in-region interexchange approval. Out-of-region outbound international service might generate "return" traffic from the same foreign administration that terminates in-region. That linkage is one of the factors that sets international service apart from domestic interexchange service and may require that any such international return traffic that terminates in-region be considered the "equivalent" of in-region service under the new Section 271(j) of the Communications Act, added by Section 151 of the 1996 Act.^{14/}

^{12/} See Comments of Vanguard Cellular Systems, Inc. (Vanguard Comments) at 4; Comments of the Telecommunications Resellers Association (TRA Comments) at 14.

^{13/} See AT&T Comments at 3 n.6.

^{14/} Since the BOCs are starting to file Section 214 applications to provide out-of-region international services, see Nynex Long Distance Co., I-T-C-96-125, filed Feb. 23, 1996, the Commission needs to decide fairly soon whether or not such services will be governed by the regulatory regime established in this docket.

II. THE INITIAL COMMENTS CONFIRM THE BOCs' MARKET POWER IN OUT-OF-REGION INTEREXCHANGE SERVICES

The initial comments document the BOCs' local exchange and access dominance and capacity to project that dominance into out-of-region interexchange services.^{15/} None of the BOCs disputes the one issue that is dispositive of their market power in out-of-region interexchange services -- namely, their continuing local exchange bottleneck control. In fact, BellSouth concedes "their market power in the provision of local exchange services."^{16/} The BOCs instead fall back on the argument that their local bottleneck control cannot be exercised in out-of-region interexchange services. As demonstrated in MCI's and others' initial comments, however, local bottleneck control, by its very nature, can be brought to bear on out-of-region interexchange services.^{17/}

Most of the BOCs try to avoid the inevitable link between the two issues by focussing on matters such as their low market shares in interexchange services, as if they were in the same position as any other interexchange carrier.^{18/} As MCI and others explain in their initial comments, however, the Commission has looked primarily to local exchange market power in analyzing

^{15/} See CompTel Comments at 1-7; TRA Comments at 1-18; AT&T Comments at 6-7.

^{16/} BellSouth Comments at 5. See also, *id.* at 12, 14; Nynex Comments at 9.

^{17/} MCI Comments at 7-10; TRA Comments at 12-18; CompTel Comments at 5-7.

^{18/} See, e.g., Comments of SBC Communications Inc. at 8-9.

BOCs' and other local exchange carriers' (LECs') interexchange market power, and that single factor has always overshadowed such facts as the BOCs' interexchange market shares.^{19/}

Some of the BOCs assert that local dominance cannot be exercised in out-of-region interexchange services for a variety of reasons, such as the geographical separation of the out-of-region services from the BOCs' local services, price cap regulation and the equal access requirements.^{20/} Bell Atlantic argues that the existence of large interexchange carrier (IXC) competitors makes any anticompetitive conduct, especially predatory pricing, utterly futile and that the BOCs could never drive the independent IXCs out of business.^{21/} The BOCs also argue that the presence of local service competition, the interconnection requirements of the 1996 Act and the supposed

^{19/} See MCI Comments at 7-10. BellSouth tries to deal with the dispositive significance of the BOCs' local bottleneck by dismissing such concerns as reflecting the obsolete "all services" approach to dominance. In BellSouth's revisionist retelling of Competitive Carrier, the pre-divestiture AT&T and other carriers were only considered dominant, at least initially, because the Commission decided to regulate any carrier as dominant in all of its services if it was dominant in any market. The AT&T Non-Dominance Proceeding supposedly ended this "all-services" approach, and BellSouth concludes that local exchange dominance thus should no longer be considered dispositive of BOC market power in other markets. BellSouth Comments at 5-9. In fact, as explained by MCI and other parties, the pre-divestiture AT&T was considered dominant because its local exchange power could be projected into markets dependent on the local exchange, not because of the "all-services" approach. That power endures and requires a similar analysis, irrespective of any "all-services" analysis.

^{20/} See, e.g., BellSouth Comments at 12-13.

^{21/} See Bell Atlantic Comments at 7.

implausibility of carrying out terminating access discrimination, as well as the ease of detection of such discrimination, negate any possibility of creating an advantage in the out-of-region market as to calls terminated in-region.^{22/}

As other parties point out, however, the opportunities for cost-shifting and discrimination are myriad, and price cap regulation is largely irrelevant to many of the types of cost-shifting that are possible. Cross-subsidies can take the form of a conferring of a wide variety of benefits derived from the BOC's monopoly operations on its interexchange services without adequate compensation. Many such benefits involve company-wide costs that, by their nature, are common to local exchange and out-of-region interexchange services.^{23/}

All of these cost or asset-shifting techniques are hard to detect and not deterred by price cap regulation. Whether or not the BOC's monopoly rates can be raised to absorb additional costs under price cap regulation, the conferring of monopoly-derived benefits on the BOC's interexchange services unfairly subsidizes those services. Since other IXCs have to obtain the same inputs at inflated market rates, the subsidizing of the BOCs' interexchange services results in unreasonable discrimination, injuring interexchange competition. Moreover, under the Commission's price cap scheme, the BOCs can always choose a lower productivity factor, with sharing, for the following year,

^{22/} See e.g., Bell Atlantic Comments at 7-8.

^{23/} See TRA Comments at 15-16; CompTel Comments at 5-6.

thereby sweetening their cross-subsidy incentives, and many states also have not implemented a "pure" price cap regime for local exchange and intrastate access services.

The BOCs can also discriminate in a variety of ways that take advantage of their local monopoly, such as slow service provisioning, delayed information about, or roll-out of, new technologies, less responsive maintenance and customer service or poor connections. They can exploit information obtained in their capacity as local service providers for out-of-region interexchange marketing, including such information as validation databases. They can also manipulate the price or other terms and conditions of the termination of traffic, including limiting access to certain signalling information associated with call termination.^{24/}

Although Bell Atlantic scoffs at the notion that a BOC would do anything so obvious as discriminate in the price or conditions of terminating access offered to competitive IXC's, various BOCs have advocated that they be given the flexibility to provide access on a contract tariff or other individual customer basis.^{25/} Such freedom would invite gross discrimination, but even the more subtle forms of discrimination mentioned above would raise competitors' costs sufficiently to injure competition. Most of these discriminatory techniques would not be affected by current

^{24/} See CompTel Comments at 4-6; TRA Comments at 14; Comments of Excel Telecommunications, Inc. at 4.

^{25/} See Sprint Comments at 2 & n.2.

equal access requirements, and the interconnection requirements of the 1996 Act will not be implemented for some time.

IXCs facing discrimination would have no practical alternatives for access, since local exchange and access competition is only just beginning to develop, especially as to residential users.^{26/} As for Bell Atlantic's insistence that the IXCs are too big to be driven from the market, antitrust cases have recognized that firms in a position to raise their rivals' costs will do so and that such behavior injures competition, irrespective of the ability or lack of ability to drive those rivals from the market.^{27/} As long as the BOCs are in a position to raise the IXCs' costs, they will do so.

Another factor reinforcing the BOCs' market power is BOC joint ventures. As already discussed above, BOC provision of interexchange CMRS opens multiple opportunities for abuse. These problems are aggravated where the CMRS is a joint venture with another BOC.^{28/} More generally, a BOC might tend to favor another BOC's affiliate offering out-of-region interexchange service in the first BOC's service area if they cooperate in any joint ventures.^{29/} In terms of the opportunities for abuse, those situations are roughly equivalent to in-region interexchange

^{26/} TRA Comments at 10-11 & n.20.

^{27/} See Ball Memorial Hospital, Inc. v. Mutual Hospital Insurance, Inc., 784 F.2d 1325, 1339 (7th Cir. 1986).

^{28/} Vanguard Comments at 5-6.

^{29/} See CompTel Comments at 12-13.

service, since the BOC providing the out-of-region service is involved in providing the originating access for the call.

References to the lack of abuses in other competitive activities in which BOCs participate are not probative of the extent of the BOCs' market power in out-of-region interexchange services. The CPE market, for example, does not depend on access to the local network. Some of the BOCs point out that independent cellular providers have thrived alongside BOC cellular operations, but, as Professor Hall has explained, that may have more to do with the fact that "independent" cellular providers are typically affiliates of other BOCs. Similarly, the success of the IXCs in the limited "corridor" markets does not suggest any particular outcome here because, as Professor Hall explains, the BOCs realize that their corridor customers still need the IXCs for the great bulk of their interexchange calls, which typically go outside the corridors. The corridor market experience thus says nothing about what will happen upon full-fledged entry of each BOC into 85% (the out-of-region portion) of the nationwide interexchange market.^{30/} Accordingly, the BOCs must be considered dominant in their provision of out-of-region interexchange services.

III. THE INITIAL COMMENTS CONFIRM THAT THE SEPARATE
AFFILIATE REQUIREMENTS SHOULD BE STRENGTHENED AND MADE
MANDATORY AND THAT ADDITIONAL SAFEGUARDS ARE NECESSARY

Most of the BOCs complain, without citing any support, that

^{30/} Declaration of Robert E. Hall at 39, United States v. Western Electric Co., Inc., CA No. 82-0192 (D.D.C. filed Dec. 2, 1994).

the proposed separate affiliate condition would impose an undue burden on their out-of-region interexchange services. Those claims, however, are belied by Pacific Telesis' support for such a requirement on competitive equity grounds.^{31/} The initial comments also explain that dominant status is necessary for BOC out-of-region interexchange services, whether or not provided through a separate affiliate, especially situations involving the types of BOC joint ventures discussed above.^{32/} The Commission's recent NPRM proposing to relieve nondominant carriers of any tariff-filing obligations raises the stakes significantly, since it would be impossible to determine whether, for example, BOC interexchange rates for traffic terminating in-region covered the BOC's terminating access charges or were otherwise predatory.

Furthermore, as various parties explain, the Competitive Carrier separate affiliate requirements, which were framed for the independent LECs, are far too lax to address the types of BOC anticompetitive conduct and cost shifting discussed above. Thus, the initial comments propose strengthened separation requirements, involving complete physical, operational and administrative separation of the BOC out-of-region affiliates from the local exchange operations, including a prohibition of

^{31/} Pacific Telesis Comments at 5-6. Nynex also does not object to the separate affiliate requirement.

^{32/} See TRA Comments at 18; Comments of the Association for Local Telecommunications Services (ALTS Comments) at 5. See also, Vanguard Comments at 5-6; CompTel Comments at 12-13. For dominant carrier regulation to be effective, of course, BOCs must be required to submit full cost support for their interexchange tariff rates. See Sprint Comments at 3 & n.3.

joint marketing and the sharing of customer proprietary network information and other confidential information. Parties also propose that there also be an explicit prohibition of any discrimination in access to Title II or other services or facilities.^{33/} It is telling that the one state regulatory agency to submit comments -- the Public Utilities Commission of Ohio (PUCO) -- proposes strengthened separation requirements along these lines.^{34/}

Accordingly, MCI supports the suggestions that, at the very least, the separate subsidiary requirements in the 1996 Act be imposed on BOC out-of-region interexchange services.^{35/} The BOCs will have to set up such subsidiaries for the same services provided in-region, so an equivalent requirement for out-of-region services will not create a significant burden.^{36/}

The PUCO objects to the proposed treatment of BOC interexchange affiliates as nonregulated affiliates for

^{33/} See, e.g., CompTel Comments at 8-11; Excel Comments at 6-7; TRA Comments at 20-22. The need for such an across-the-board non-discrimination rule is underscored by Pacific Telesis' view that nontariffed services provided by the BOC to its interexchange operations would not have to be offered to all others on the same basis. See Pacific Telesis Comments at 7.

^{34/} See PUCO Comments at 4-6.

^{35/} See, e.g., CompTel Comments at 9-10; Sprint Comments at 3-5.

^{36/} See Excel Comments at 6. Bell Atlantic's reading of the statutory separate subsidiary requirement (see Bell Atlantic Comments at 4-5) is incorrect. The requirement in the new Section 272(b)(1) that the separate interexchange subsidiary operate independently from the BOC and the requirement of separate employees in Section 272(b)(3) forbid joint ownership of facilities as well as joint marketing and shared employees.

accounting purposes, given the need to ensure that state ratepayers do not bear interstate interexchange costs.^{37/} Some accounting separation between the BOCs' interexchange and local exchange operations is necessary to prevent cost shifting between them,^{38/} however, underscoring MCI's concern that there be a "four-way" accounting separation imposed on BOC interexchange operations, so that local exchange and access services do not confer benefits on the interexchange operations and there is no cost shifting between the interexchange operations and unregulated activities.

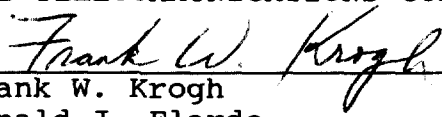
CONCLUSION

Accordingly, the BOCs' out-of-region interexchange services should be subject to mandatory separate subsidiary requirements at least as stringent as those set forth in the 1996 Act for in-region services, dominant carrier regulation and the accounting safeguards discussed herein and in MCI's initial comments.

Respectfully submitted,

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^{37/} PUCO Comments at 7-8.

^{38/} See AT&T Comments at 8-9.

CERTIFICATE OF SERVICE

I, Sylvia Chukwuocha, do hereby certify that the foregoing REPLY COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION were served this 25th day of March, 1996, by first-class mail, postage prepaid, on the following parties listed below:

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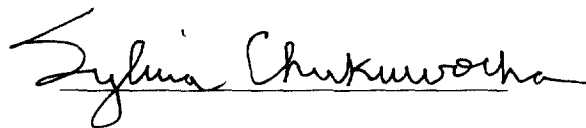
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A handwritten signature in cursive script, reading "Sylvia Chukwuocha". The signature is written in black ink and is positioned above a horizontal line.

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